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C O N F I D E N T I A L CARACAS 000426

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TAGS: [EPET](#) [ENRG](#) [EINV](#) [ECON](#) [VE](#)
SUBJECT: BRV PUBLISHES OIL NATIONALIZATION DECREE

REF: CARACAS 411

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D)

¶1. (C) SUMMARY: The oil nationalization decree, which was published on February 26 but publicly available on February 27, requires the four strategic associations, the three profit sharing agreements, the Chinese Orimulsion company Orifuels Sinoven S.A. and any related entities "that carry out commercial activities in the Faja region" to convert to PDVSA-controlled joint ventures. In addition to the terms set out by President Chavez in his February 26 speech, the decree states that transition committees that will sit on association boards must be created within seven days. Article 8 appears to give the BRV the ability to revoke joint venture's property rights if operators do not meet the joint venture's objectives. Article 9 permits the BRV to limit the joint venture's block sizes. Joint venture employees will be subject to the PDVSA collective bargaining agreement. Lastly, the decree appears to eliminate international arbitration for joint venture partners. END SUMMARY.

SCOPE OF THE DECREE

¶2. (SBU) The BRV published the oil nationalization decree in the Official Gazette dated February 26. Copies of the decree were not available until the afternoon of February 27. The scope of the decree appears to be more limited than what President Chavez stated in his February 26 speech (Reftel). According to Article 1 the decree applies to the four strategic associations, the three profit sharing agreements, the Chinese Orimulsion company Orifuels Sinoven S.A., companies and consortia created to carry out the association's activities, and affiliates of the previously mentioned companies that "carry out commercial activities in the Faja region." President Chavez appeared to state on February 26 that the decree applied to third party companies that carried out commercial activities in the Faja. Chavez'

comments appeared to indicate that service companies operating in the Faja were subject to the nationalization decree. It is not clear if Chavez misspoke or based his statement on a previous draft of the decree. (NOTE: The decree uses the term "associations" throughout. Given the context, we believe the term refers to all of the private sector entities in Article 1. A partner of the Baker & McKenzie law firm told Petroleum Attache (Petatt) on February 28 that that was his interpretation as well. END NOTE)

CONTROL AND TIMING

¶3. (SBU) As President Chavez stated on February 26, the decree states that the Venezuelan Petroleum Corporation (CVP), the PDVSA affiliate that deals with foreign oil companies, or another PDVSA affiliate will control at least 60% of the shares of the new joint ventures. The decree empowers the Minister of People's Power for Petroleum and Energy (MPPEP) to determine in each case the value of each joint venture, the percentage of shares the PDVSA affiliate will hold in each joint venture, and the economic and financial adjustments that are necessary to create the joint ventures.

¶4. (C) The decree also mandates that a transition committee for each joint venture be set up within seven days of the publication of the decree. The committees will be incorporated into the board of directors of each of the entities that is migrating to a joint venture. (COMMENT: At this point, we are not sure how many entities are covered by the decree or the number of transition committees that will be formed. It is not clear how many consortia and affiliates have been formed to carry out operations. For instance, an ExxonMobil subsidiary carries out operations at the Cerro Negro strategic association. We assume that it will need a transition committee. Whether the BRV will form a separate transition committee for the subsidiary or create a single committee to cover both Cerro Negro and the ExxonMobil operating subsidiary remains to be seen. END COMMENT)

¶5. (SBU) The decree states the private sector companies will have four months from the date of publication to reach agreement on the terms for their participation in the joint ventures. The National Assembly will then have an additional two months to authorize the joint venture under the terms of the Organic Hydrocarbon Law. If terms are not reached within the four month time period, PDVSA or one of its affiliates is empowered to directly assume "the activities exercised" by the private sector company.

¶6. (SBU) The infrastructure, transport services, and upgrading services of the private sector companies will be used along the lines set forth in resolutions by the Energy Ministry (MEP). The costs of using the assets will be jointly determined by the private sector companies and MEP. However, MEP may determine the costs on its own if the parties fail to reach agreement.

MOTHER OF ALL LOOPHOLES?

¶7. (C) Article 8 of the decree states the BRV, via decree, will transfer to the joint ventures "the right to exercise their primary activities". In addition, the BRV will award property or other rights to real estate and other assets under its control so that the joint ventures can carry out their primary activities. However, the BRV reserves the right to revoke these rights if "the operators" do not "fulfill their obligations in such a way that it impedes the objective for which the rights were transferred." The Baker & McKenzie partner stated the section tracks the language of Article 24 of the Organic Hydrocarbons Law (OHL). He stated he thought the language was a double-edged sword. It appears that any party to the joint venture could invoke the provision.

¶8. (C) It is not clear what will constitute the primary

activities of the joint ventures. The Baker & McKenzie partner stated the "fulfill their obligations" language is so vague, it is impossible to determine what the criteria are for the provision. Local analysts told Petatt on February 27 that they were concerned the BRV would use the provision to force their private sector partners to significantly increase their social development contributions. In addition, we note that the provision could be used to force private sector companies to invest in enhanced recovery projects in order to increase recovery rates in the Faja. The BRV has been keen to force oil companies in the Faja to adopt enhanced recovery technologies to increase recovery rates for some time. Local oil analysts and ExxonMobil executives have told us that the BRV's plans may not make any sense given the nature of the Faja's reservoirs. At the present time, the four strategic associations are using cold flow production (the oil flows naturally due to reservoir pressure). An ExxonMobil executive stated that it may be 10 years before the reservoir pressure is low enough to introduce the enhanced recovery methods that PDVSA advocates.

BLOCK SIZE

¶9. (C) Under Article 9 of the decree, MPPEP, via a resolution published in the Official Gazette, will delimit the blocks where joint ventures can carry out their primary activities. The maximum size of a block is 100 square kilometers.

LABOR ISSUES

¶10. (C) All employees on the associations' payroll will be covered by the Oil Collective Convention, the collective bargaining agreement that governs PDVSA employees, upon entry into force of the decree. The Baker & McKenzie partner stated the provision means that none of the current private sector employees can be fired. He speculated that the PDVSA Oil Collective Convention would provide a floor for employee compensation but not act as a ceiling. A partner at a local Venezuelan law firm told Petatt on March 1 that the article only applies to private sector employees who are subject to previous collective bargaining agreements with their private sector employers. Managers, for example, are not covered by the provision. In addition, she stated contractors' employees are not covered by the provision. Local analysts believe that the private sector employees will eventually face pay cuts when they fall under the PDVSA collective bargaining agreement, since many employees in the former operating service agreement fields had their pay cut after the agreements were converted to PDVSA controlled joint ventures.

ARBITRATION

¶11. (SBU) Article 13 of the decree states "all facts and activities related to the present decree" and "the controversies" that derive from them are subject to Venezuelan jurisdiction in the form set forth by the Venezuelan constitution. Article 34 (b) of the OHL seems to state that international arbitration can only occur if both parties agree to it.

¶12. (C) The Baker & McKenzie partner viewed the provision as "fatal" to international arbitration. He noted the "activities" language did not limit the provision to the underlying contract. In addition the language on the Venezuelan constitution in his opinion refers to Article 151 of the constitution. Article 151 states that public interest contracts are considered to incorporate a clause that requires the resolution of "doubts and controversies" by Venezuelan courts. In addition, the doubts and controversies do not give rise to foreign claims under any circumstance.

¶13. (C) The partner was not sure how far the BRV would go in claiming that international arbitration could not be utilized

by private sector companies affected by the decree. He opined that it would be difficult to make the claim if the company in question fell under the protection of a bilateral investment treaty with an arbitration clause.

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